

STATE OF SOUTH CAROLINA
RICHLAND COUNTY

IN THE COURT OF COMMON PLEAS
FIFTH JUDICIAL CIRCUIT

Scott H. Richardson, as Director of the South
Carolina Department of Insurance,

Petitioner,

vs.

Capital Assurance Risk Retention Group, Inc.

Respondent.

Civil Action Number 07-CP-40-06972

**CONSENT ORDER
COMMENCING
REHABILITATION
PROCEEDINGS & GRANTING
AN INJUNCTION &
AUTOMATIC STAY OF
PROCEEDINGS**

This matter comes before me pursuant to the South Carolina Insurer's Rehabilitation and Liquidation Act, S.C. Code Ann. §§ 38-27-10 *et seq.* Petitioner seeks an order appointing him as Receiver of Capital Assurance Risk Retention Group, Inc., (Respondent) for purposes of rehabilitation. Respondent has been served with a copy of the aforementioned Petition pursuant to Section 38-27-60 of the South Carolina Code.

The Court, having reviewed the pleadings of record and otherwise being fully informed in the premises, finds:

1. This Court is the proper venue for this proceeding pursuant to S.C. Code Ann. § 38-27-60(f) & -310 (2002).
2. Petitioner is the duly appointed Director for the State of South Carolina Department of Insurance with such powers, duties and responsibilities as are prescribed under the insurance laws of this State to the Director for company licensing, delinquency and receivership matters, and is specifically authorized to file a petition for rehabilitation pursuant to S.C. Code Ann § 38-27-350 (2002).

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3. Respondent is a privately held South Carolina captive (stock) insurance company formed as a Risk Retention Group and organized and licensed under the provisions of S.C. Code Ann. §§ 38-90-10 *et seq.*

4. Respondent is not a publicly-traded corporation; it is owned by its policyholders, whose percentage of ownership is estimated as follows:

- a. The Ultimate Warranty Corporation ("Ultimate"): 80%;
- b. Extended Auto Warranty Corporation: 19.99%;
- c. Mechanical Breakdown Administrators; Warranty America, LLC; Warrantech Automotive, Inc.; and First Warranty Group: one share each;
- d. Ultimate Warranty of Arizona and Ultimate Warranty of Wisconsin: undetermined

5. The Department has regulatory jurisdiction over the Respondent, but has limited regulatory authority with respect to one or more of its owners. As stated in the Report of Examination as to the Financial Condition and Market Conduct Affairs of Respondent as of December 31, 2005, Ultimate's estimated claims liabilities discounted at 3.5% were twelve million dollars (\$12,000,000) greater than its assets set aside to pay claims of forty nine million three hundred thousand dollars (\$49,300,000).

6. In the Report of Examination, the South Carolina Department of Insurance ("the Department") required Respondent to eliminate this shortfall of twelve million dollars (\$12,000,000) by December 31, 2008 and also required Respondent to show evidence that the underlying assets counted by an independent actuary in computing the shortfall were maintained in trust for the purpose of paying the claims of the underlying warranties and/or service contracts, as well as

evidence of sufficient liquidity, quality and diversity of these assets.

7. Respondent's filed 2006 Annual Statement reflected five million sixty-seven thousand two hundred fifty-four dollars (\$5,067,254) of surplus to pay policyholders.

8. Respondent did not have sufficient surplus to make up for the shortfall of twelve million dollars (\$12,000,000).

9. Respondent's 2006 Actuarial Report indicated that Ultimate had sixty-seven million five hundred thousand dollars of undiscounted future claim payments (\$67,500,000) and forty-eight million dollars (\$48,000,000) in Loss Reserve Funds, *i.e.*, funds established to pay claims on vehicle service contracts issued by Ultimate under the policy of insurance between Ultimate and Respondent, the exhaustion of such funds being a prerequisite to payment under that policy.

10. Pursuant to 25A S.C. Code Regs. 69-60 § 3 (Cum. Supp.), Respondent was required to submit an audited financial report to the Director on or before June 30, 2007 for January 1, 2006 to December 31, 2006, inclusive.

11. Respondent failed to submit a timely audited report, notwithstanding being granted two extensions, the second ending August 31, 2007.

12. On or about August 27, 2007, and after Respondent indicated that it was not going to file an audited financial statement by August 31, 2007, the Department conducted a meeting at its offices with representatives of Respondent, including the President, Anthony R. Scatena, and Respondent's independent auditors.

13. Based on a review and further analysis of information obtained during the August 27, 2007 meeting and further examination of Ultimate's financial condition on or about October 10-12, 2007, the Department has determined that of the purported forty-eight million sixteen thousand six

hundred forty-five dollars (\$48,016,645) in Loss Reserve Funds, approximately sixteen million four hundred fifty thousand six hundred twenty-five dollars (\$16,450,625) consisted of receivables from various affiliated companies of Ultimate and approximately seven million six hundred forty-two thousand dollars (\$7,642,000) was actually a receivable from American Resource Insurance Company (ARIC) (a company with which Respondent had previously had a reinsurance agreement), leaving only approximately twenty-three million nine hundred twenty-four thousand twenty dollars (\$23,924,020).

14. As of August 31, 2007, Ultimate's net Loss Reserve Funds actually totaled only two million six hundred forty-six thousand six hundred eighty-three dollars and sixty cents (\$2,646,683.60) in various bank accounts, including one account with a balance of two million fifty-seven thousand fifty-six dollars and twenty-eight cents (\$2,057,056.28) that is substantially controlled by MEPCO Finance Company, a finance company used by Ultimate to finance the purchase of vehicle service contracts.

15. On September 10, 2007, in response to a request for further documentation regarding the assets of Ultimate, the Department received a spreadsheet showing a total balance of the Loss Reserve Funds bank accounts, as of August 31, 2007, in the amount of nineteen million three hundred twenty-four thousand six hundred nine dollars and seven cents (\$19,324,609.07); however, Respondent and Ultimate have since conceded that, of this total, six million five hundred forty thousand two hundred forty-two dollars and twenty-six cents (\$6,540,242.26) were actually in bank accounts owned solely by Respondent, two million two hundred eighty-nine thousand ten dollars and sixty-two cents (\$2,289,010.62) were in bank accounts encumbered by letters of credit, three million eight hundred forty-eight thousand six hundred seventy-two dollars and fifty nine cents

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(\$3,848,672.59) were receivables from Ultimate's affiliated companies and four million dollars (\$4,000,000) consisted of a receivable from ARIC.

16. On September 10, 2007, the Department held a telephone conference call with Scatena and Michael Clark, a Vice President and Director of Respondent and a principal in Ultimate, as well as a number of service providers of Respondent and Ultimate.

17. During the above-described conference call, Clark stated that, on September 7, 2007, Ultimate paid seventy-five thousand dollars in claims payments, completely exhausting its cash in the loss reserve funds and also acknowledged that current unpaid warranty claims against Ultimate were seven hundred eighty-seven thousand dollars (\$787,000) in claims outstanding.

18. During the same conference call, Clark indicated that Ultimate exhausted its cash reserves on September 7, 2007 and began obtaining funds on a daily basis in order to pay claims, stated that sixty thousand dollars (\$60,000) was placed into Ultimate's account on September 10, 2007 to pay claims in the same amount and indicated that he expected to be able to acquire another one hundred twenty-five thousand (\$125,000) to place into Ultimate's bank account the following day in order to pay claims in that amount.

19. Also during the same conference call, Clark indicated that Ultimate was seeking a loan of \$500,000 in order to pay claims outstanding.

20. The Department has conducted numerous meetings and conference calls with representatives of Respondent and Ultimate regarding Respondent's ability to continue to operate as a going concern due to the deteriorating financial condition of Ultimate

21. On or about September 11, 2007, the Director issued a Confidential Order Imposing Administrative Supervision and Appointing Supervisor with respect to Respondent on the grounds

that (a) Ultimate's deteriorating financial condition, the full extent of which had only recently been discovered, placed Respondent in a hazardous financial condition and (b) Respondent failed to file a timely audited financial report in compliance with State law. *See* S.C. Code Ann. §§ 38-26-40(A)(1) & (3) and 38-26-50 (2002).

22. On September 19, 2007, the Supervisor requested that Ultimate provide a daily report to the Department of Insurance of the amount of cash available to pay claims and the amount of outstanding claims.

23. The first report, which was for September 25, 2007, showed sixty-two thousand seven hundred seventy-four dollars and eighty cents (\$62,774.80) available to pay claims and one million one hundred eighty-two thousand three hundred forty-two dollars and eighty-four cents (\$1,182,342.84) in outstanding claims.

24. On or about September 27, 2007, representatives of Ultimate reported that Ultimate was out of funds to pay claims and was seeking funds from Respondent in order to continue operations.

25. On or about October 2, 2007, Ultimate wrote to Respondent with reference to "Service Contract Reimbursement Insurance Policy (CARRG 01-07): Notice of Loss and claim by Insured, The Ultimate Warranty Corp. (the 'Notice of Loss and Claim')," with an attached Exhibit A summarizing purported "Total Claims" of \$1,406,679.31, "Total Cancells" of \$333,264.04 and a "Grand Total" of \$1,739,943.35, and requesting Respondent to pay "the 'Covered Claims and 'Covered Amounts.'"

26. Respondent has requested and received one additional 30-day extension in which to file its audited financial report and one further 10-day extension, for a total extension of time of

approximately 100 days, and still has failed to file that report.

27. Ultimate's latest reporting of cash available and outstanding claims, which was as of October 11, 2007, showed twelve thousand nine hundred seventeen dollars and ninety-one cents (\$12,917.91) in cash available to pay claims and one million eight hundred seventy-eight thousand eight hundred thirty six dollars and ten cents (\$1,878,836.10) in outstanding claims. Additionally, its actuaries have indicated that the reserve deficit is currently \$44,000,000.

28. S.C. Code Ann. Section 38-27-310 sets forth the grounds upon which an insurer may be placed into rehabilitation, including but not limited to when the insurer is in a condition in which the further transaction of business would be hazardous, financially, to its policyholders, creditors, or the public and/or when the board of directors or the holders of a majority of the shares of stock entitled to vote request or consent to rehabilitation. Pursuant to this section of the Code, the Director may apply by petition to the Circuit Court for an Order authorizing him to rehabilitate Respondent.

29. The insurer has failed to file its annual report or other financial report required by statute within the time allowed by law and, after demand by the director or his designee.

30. In light of the financial issues involving its owner, Ultimate, Respondent is in such condition to be hazardous, financially, to its policyholders, its creditors and the public.

31. The Board of Directors of the Respondent has authorized each of its officers to consent to an Order of Rehabilitation, and the signature of any said officer on this document shall constitute said written consent and its filing with the Court.

32. Respondent consents to the facts set forth herein only for purposes of obtaining this Consent Order, and Respondent reserves the right to contest these facts in any other proceeding or action.

33. The Court has jurisdiction over this matter.

34. It is in the best interest of Respondent, its policyholders, its creditors and the public that the relief requested in the petition be granted.

IT IS THEREFORE ORDERED THAT:

1. PURSUANT TO S.C. Code Ann. § 38-27-310 and 38-27-320 (2002), Petitioner and his successors in office are appointed Receiver for the purposes of rehabilitation of Respondent.

2. PURSUANT TO S.C. Code Ann. § 38-27-330 (2002), Petitioner and his successors shall have all the powers and responsibilities set forth under that section to assist him or his designee as Receiver for Rehabilitation, including but not limited to:

a) Conducting the business of Respondent and taking all steps, as the Court may direct, toward the removal of the causes and conditions which have made this Order necessary and taking such further action as the Receiver deems necessary or appropriate to reform and revitalize Respondent.

b) Taking immediate possession of all the property, assets and estate, and all other property of every kind whatsoever and wherever located, belonging to Respondent.

c) Applying for any restraining orders, preliminary and permanent injunctions, and other orders considered necessary pursuant to S.C. Code Ann. Section 38-27-70.

d) Employing and authorizing the compensation of legal counsel, actuaries, accountants, consultants and other assistants as it deems necessary, and authorize the payment of the expenses of these proceedings and the necessary incidents thereof, as approved by the Court, to be paid out of the funds or assets of Respondent that are in the possession of the Receiver or that come



into his possession.

e) Imposing, if, within the Receiver's sole judgment, it is determined to be necessary, a moratorium on the payment of claims with consideration given to hardship exceptions, whereby claims meeting certain established criteria would be paid at a pre-determined percentage or amount. In establishing such procedures, the Receiver shall be fully informed as to coverage issues and how claims will be handled in the future. If the Receiver implements a hardship procedure, approved by the Court, it shall be detailed and carefully documented, and shall include an appeal process. These procedures must include a complete description of the information that needs to be submitted by the policyholder requesting the hardship payment and the methodology utilized to evaluate that information.

(f) If it appears to the Receiver that there has been criminal or tortious conduct or breach of any contractual or fiduciary obligation detrimental to the insurer by any officer, manager, agent, broker, employee, or other person, pursuing all appropriate legal remedies on behalf of the insurer.

3. In the event the Receiver determines that reorganization, consolidation, conversion, reinsurance, merger or other transformation of Respondent is appropriate, the Receiver is directed to prepare a plan to effect such changes and submit the plan to this Court for consideration.

4. Whenever the Receiver believes further attempts to rehabilitate an insurer would substantially increase the risk of loss to creditors, policyholders, or the public or would be futile, the Receiver may petition the Court for an Order of Liquidation. The Court shall permit the directors of the insurer to take actions reasonably necessary to defend against the liquidation petition and may order payment from the estate of the insurer of costs and others expenses in defense as justice

requires pursuant to S.C. Code Ann. § 38-27-350 (2002).

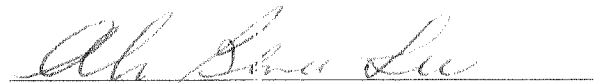
NOTICE OF AUTOMATIC STAY

Notice is hereby given that pursuant to S.C. Code Ann. § 38-27-70, the Court grants an automatic stay applicable to all persons and proceedings, other than the Receiver, which shall be permanent and survive the entry of the Order and which prohibits:

- 1) The transaction of further business;
- (2) The transfer of property;
- (3) Interference with the Receiver or with a proceeding under Chapter 27 of Title 38 of the Code;
- (4) Waste of the insurer's assets;
- (5) Dissipation and transfer of bank accounts;
- (6) The institution or further prosecution of any actions or proceedings;
- (7) The obtaining of preferences, judgments, attachments, garnishments, or liens against the insurer, its assets, or its policyholders;
- (8) The levying of execution against the insurer, its assets, or its policyholders;
- (9) The making of any sale or deed for nonpayment of taxes or assessments that would lessen the value of the assets of the insurer;
- (10) The withholding from the receiver of books, accounts, documents, or other records relating to the business of the insurer; or
- (11) Any other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors, or shareholders, or the administration of any proceeding under Chapter 27 of Title 38 of the South Carolina Code.

This Court retains jurisdiction of this cause for the purpose of granting such other and further relief as from time to time may be necessary and appropriate.

AND IT IS SO ORDERED.



Alison R. Lee
Chief Administrative Judge
Fifth Judicial Circuit

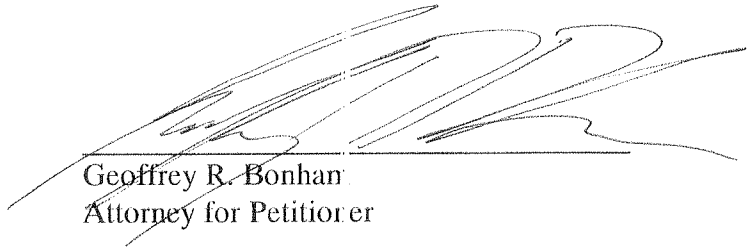
This 31st day of October 2007
Columbia, South Carolina



WE CONSENT:



Anthony R. Scatena, President
Capital Assurance Risk Retention Group
Respondent



Geoffrey R. Bonhan
Attorney for Petitioner

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